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EMERGING COVERAGE ISSUES IN EMPLOYMENT PRACTICES LIABILITY INSURANCE: THE INDUSTRY PERSPECTIVE ON RECENT DEVELOPMENTS

JEFFREY P. KLENK*

INTRODUCTION

The 1990's saw the birth of Employment Practices Liability Insurance, the most talked about insurance product today. As exposure has evolved throughout the decade, so too has the coverage in available insurance policies. This piece discusses some of the more critical coverage issues and their evolution.

I. THE ORIGINS OF INSURANCE COVERAGE FOR EMPLOYMENT PRACTICES LIABILITY

As has been true for all lines of insurance, the development of an employment practices liability insurance product quickly followed exposure to employment-practices liability. With employees suing their employers on an almost routine basis, Employment Practices Liability Insurance ("EPLI") has become the hottest selling, most talked about insurance product today. With the insurance industry experiencing an undisputed "soft market" condition, premiums from EPLI represent a much needed growing source of revenue for insurance companies. Consequently, insurers are competing aggressively to keep their policy forms on the cutting edge to entice brokers and potential insureds to choose their product.

In 1991 the EPLI market received a "kick start" due to several events that focused the nation's attention on the liabilities associated with employment practices. First, the Civil Rights Act of 1991¹ was enacted. This Act contained two provisions that drastically changed the employment practices environment. The first allowed

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1. PUB. L. No. 102-166, Nov. 21, 1991, 105 Stat. 1071.

plaintiffs to recover punitive damages, thereby raising the potential stakes for employee-plaintiffs and their attorneys. The second permitted jury trials for these cases, displacing more conservative federal judges who commentators have long argued favored employers in Title VII cases. In a jury trial, employers' actions are judged by a panel of individuals in the mainstream workforce. Most of the members of the jury are themselves employees, who may have had a bad work-related experience. The introduction of juries into the decision-making process promised to produce a marked difference in the outcome of these cases.

The Clarence Thomas confirmation hearings was another event in 1991 that focused the nation's attention on employment practices. For the first time in our nation's history, "sexual harassment" was being discussed in our Congress, places of business, coffee shops, and in our homes. The allegations made by Anita Hill both shocked our conscience and stimulated our discussion of the appropriateness of this type of conduct in the workplace. Shortly after these hearings, the nation was again forced to confront the reality of sexual harassment when the Navy Tailhook scandal broke. After the media attention generated by these two events, sexual harassment has remained on the front pages of newspapers to this day.

With sexual harassment and employment practices continually in the newspapers and on television, the number of these claims began to rise steadily from 1991 to the present.² As the number of claims rose, the idea of using insurance as protection against these liabilities began to take hold.

The first insurance markets to be hit with these types of employment related claims were the General Liability ("GL") carriers. Claims were submitted under the theory that this type of harm was somewhat "bodily" in nature, and therefore, mental anguish and emotional distress, for example, should be covered under the GL policy. The GL markets, quickly realizing that they were paying claims that they originally had no intention of covering, began using "employment related claims exclusions" in their policy forms. Some GL carriers were quicker to respond than others, but this position is fairly standard in the GL arena today.

With exposure growing, some professional liability carriers be-

2. Sexual harassment filings with the U.S. Equal Employment Opportunity Commission between 1992-1998 are located on its website (visited Sept. 29, 1999) <<http://www.eeoc.gov/stats/harass.html>>. In 1992, 10,532 filings were made with the EEOC, compared to 15,618 filings in 1998. See *id.*

gan endorsing their Directors' & Officers' ("D&O") and Error & Omissions ("E&O") policies to cover non-entity employment practices liability coverage. This endorsement provided coverage for named insureds in their individual capacity for employment practices liability claims. The inadequacies of this coverage soon became apparent. First, employment practices liability claims tended to be brought not against individuals, but against the corporation itself. Without entity coverage, EPLI is virtually worthless. Second, protecting only named insureds was very limiting because the individual offender being sued tended not to be a director or officer of a company. While later EPLI endorsements expanded the named insured for purposes of an employment practices liability suit to include all employees of the organization, the lack of entity coverage defeated any realistic protection from these claims.

After these early attempts, EPLI emerged as a new form of coverage. Shortly after the events of 1991, some insurance companies began offering the first "stand alone" EPLI policies, which were designed specifically to cover employment practices liability claims, and only these claims. The nearly universal feedback from customers and brokers about these early policies was that the coverage was poor and the pricing was too high. As a result, not many of these policies were sold. The initially conservative approach of the insurance community is not surprising in light of the lack of numerical data available to help the insurers set their rates appropriately. For example, as recently as January 1996, only one domestic insurance carrier offered EPLI coverage that specifically covered punitive damages in the main policy form. With punitive damages being such a large percentage of the exposure in a typical large employment claim, the lack of punitive damages protection in the standard forms provided strong evidence of the conservative posture of many of the EPLI carriers.

It was not until 1996 that the insurance industry developed a saleable and comprehensive EPLI product. Having set forth the background and development of these modern products, the next part of this Article will explore the different coverages that have become an integral part of EPLI.

II. EXPANSION OF COVERAGE FOR CLAIMS ORIGINALLY COVERED BY EPLI POLICIES

The three types of employment claims that were covered in the original EPLI policies were sexual harassment, discrimination, and

wrongful termination. Discrimination has been fairly consistently defined in EPLI policies since the policies were developed, but the legal definition of discrimination has expanded. As just one example, the federal and state governments have continued to expand the categories that are considered "protected classes." As the scope of coverage of discrimination statutes expands, a marketable and comprehensive EPLI policy will accommodate the growing exposure. Toward this end, most policies contain a "catch all" provision at the end of their discrimination definition such as the following: "because of such person's race, color, religion, age, sex, national origin, disability, pregnancy, sexual orientation or preference, *or other status protected pursuant to any applicable federal, state or local statute or ordinance.*"³ Although this definition specifically mentions sexual orientation discrimination as a "status protected pursuant to any applicable" law, it would be covered even in the absence of its specific mention, provided that federal, state, or local law holds that status as "protected." The types of characteristics that qualify as a "protected" status can change suddenly and frequently. The EPLI policy must be versatile enough to accommodate changing conditions.

Wrongful termination was originally designed to cover only the termination of an individual that violated law or some implied agreement to continue employment. This narrow view has been replaced by a focus on the employee's loss of "position." Consider the following definition: "'*Wrongful Termination*' means the actual or constructive termination of the employment of, or demotion of, or failure or refusal to promote, any *Employee* which is in violation of law or is against public policy, or is in breach of an implied agreement to continue employment."⁴ In examining the above definition, there are several expansions over the old wrongful termination coverage. First, the termination can be actual or constructive. Under the old definitions, the conduct needed to have been an outright firing. In reality, employees tend to be given the signal that they should find employment elsewhere without being fired. This "constructive" termination may take many forms, but the net effect is equivalent to terminating the person's employment. The definition also includes demotions and failure to promote someone. In essence, "wrongful termination" no longer refers to being termi-

3. Executive Risk's EPLI Policy, II(D) (2/97 ed.) (emphasis added).

4. Executive Risk's EPLI Policy, II(R) (2/97 ed.).

nated, but more accurately refers to changes in an individual's position within the organization.

Sexual harassment liabilities have also changed substantially since 1991. Conduct of a sexual nature is no longer deemed to be sexual harassment only when it is made the basis for employment-related decisions, as in the traditional "quid pro quo" cases. Today, sexually laced conduct can create a "hostile environment" that interferes with an individual's performance at work or their ability to do their job. For a hostile environment claim to be sustained, the conduct need not even be directed at the individual making the sexual harassment claim, but can merely be present in the alleged victim's workplace. For example, one of the most commonly cited examples of hostile environment claims concerns pornographic calendars present in the workplace that can be seen by the offended party. Insurance policies today almost universally address the risk of hostile workplace exposure.

III. THE EXPANSION OF CLAIMS COVERED BY EPLI POLICIES

In addition to the expansion of the three original causes of action covered by EPLI, additional coverages have been added. The following covered claims represent the most common additions to EPLI policies in 1997 and 1998.

A. *Retaliation*

"Retaliation" as a claim began gaining popularity around 1995. Simply put, retaliation involves any retaliatory treatment against an employee on account of exercising any of their rights under law. The first large claim of this kind was brought against Triton Energy. The former CFO of the company alleged that he was being retaliated against, including eventual termination, for his failure to sign what he believed to be fraudulent Securities and Exchange Commission documents. Clearly, people have a right under the law not to be forced to commit a crime in order to preserve their jobs. The CFO sued the company and received a verdict of \$120,000,000, of which \$80,000,000 was punitive damages.

Under today's broad definitions of "wrongful termination," most retaliation claims would be covered even without the specific inclusion of coverage for "retaliation." But in those situations where the retaliatory treatment has not resulted in a tangible job-related consequence, such as demotion or firing, retaliation cover-

age will protect the company against claims of emotional distress resulting from retaliatory treatment.

B. *Harassment*

"Harassment" coverage has been broadened to include harassment of a non-sexual nature. While the case law surrounding this type of claim is still developing, the better EPLI policies have begun offering coverage for claims by employees for non-sexual harassment. Harassment of a non-sexual nature tends to be defined like sexual harassment hostile work environment claims: "workplace harassment (i.e., harassment of a non-sexual nature) which creates a work environment with the *Named Insured* or a covered *Subsidiary* that interferes with performance, or creates an intimidating, hostile, or offensive working environment."⁵ Typical situations that would constitute this non-sexual harassment include patterns of verbal abuse and demeaning comments made to or about an employee. While not sexual in nature, this kind of treatment can certainly impact on the recipient's work performance and cause a great deal of mental distress.

C. *Other Workplace Torts*

Finally, there has been an increasing tendency by insurance carriers to include coverage for other types of employment-related torts. These claims are becoming more common as creative plaintiffs' lawyers are attempting to avoid the caps on awards that may be present in statutory causes of action such as Title VII claims. By "adding on" claims for tort causes of action, a plaintiff can expand the scope of compensatory relief available, as well as avoid any statutory limitations on punitive damages. Typical examples of these tort claims are defamation, invasion of privacy, and intentional infliction of emotional distress.

1. Defamation

Defamation is a claim that one's personal reputation has been wrongly called into question by the inaccurate or misleading comments of another. In the employment context, it is encountered in many situations. For example, comments made in an employee review can be the basis of a defamation claim. Investigations related to accusations of inappropriate conduct are also an area ripe for

5. Executive Risk EPLI Policy II (G)(2) (2/97 ed.).

defamation claims (e.g., sexual harassment allegations). More commonly, however, defamation claims have arisen in the reference situation. If a letter of reference or a verbal reference insinuates a lack of competence or relates some misconduct by the employee, a defamation claim could result. As these claims become more common, the inclusion of this coverage in an EPLI policy becomes more important.

2. Invasion of Privacy

Invasion of Privacy is defined differently in various jurisdictions. The two most common examples of these claims relate to disclosure of private facts and invasive surveillance or investigation of an individual. An example of the "disclosure of private facts" situation might arise where an employee with the AIDS virus shares that information in confidence with the company human resources manager for health benefit reasons. If the human resources manager decides to share the employee's medical condition with anyone else, the affected employee might have an invasion of privacy claim. These types of claims have also arisen in connection with the disclosure of facts in an employee's personnel file.

3. Invasive Surveillance or Investigation

Invasive surveillance or investigation invasion of privacy claims have also become more popular. Typical examples of this conduct might include an employer searching an employee's desk, or monitoring employees at their desks by video camera. These claims may also result if the company investigates the legitimacy of an employee's disability leave by hiring an investigator to watch the employee and make certain that the employee is truly disabled.

4. Intentional Infliction of Emotional Distress

Intentional infliction of emotional distress claims assert that the employer was responsible for some outrageous conduct that was intended to cause emotional harm to the plaintiff-employee and in fact did cause that harm. However, the conduct needs to be truly "outrageous" to support a claim. Examples of this type of conduct have included a manager's repeated use of racial epithets towards an employee. An even more outrageous example involved a forced strip search of an employee to satisfy a customer who believed that an employee had stolen her money even though the manager believed that the employee *had not* stolen the money.

Other types of workplace torts are being added to EPLI policies as well. Claims for negligent evaluation, misrepresentations, deprivation of career opportunities, negligent hiring and retention, and a variety of other issues that do not fall "neatly" under any of the traditional employment categories have been included within the scope of coverage. None of these other categories are currently generating significant claims activity, but as employment law evolves and more lawsuits are filed, one or more of these other categories may become a mainstream type of employment claim.

IV. EPLI COVERAGE FOR CLAIMS BROUGHT BY NON-EMPLOYEES

Employers have historically used EPLI for claims brought by employees for employment-related problems, hence the "E" in EPLI. As noted above, though, when a new exposure to liability presents itself, the insurance tends to follow. In recent years, the Denny's restaurant chain has faced several racial discrimination lawsuits on behalf of African-Americans, and in 1994, settled two lawsuits for \$45 million dollars.⁶ Other restaurants have suffered similar race discrimination allegations. While this type of claim has nothing to do with the employment relationship, the "discrimination" element makes this liability a close fit for EPLI.

Aside from discrimination claims, the other main third-party employment practices liability claim is sexual harassment. The typical situation for this type of claim involves unwanted sexual advances toward a customer by an employee. Clients, customers, vendors, or other third parties with whom an organization's employees interact can certainly bring a lawsuit against the offending employee. The organization itself could also be liable for the conduct of the employee in certain situations, such as where they knew of the employee's propensity to harass, but still placed the client in contact with that employee.

Obviously, these third-party discrimination and sexual harassment claims are most likely to occur in an industry that has a great deal of interaction with third parties. Examples of industries with the greatest exposure to these third-party claims are restaurants, retail sales, doctors' offices, law firms, and other service-related businesses. While these particular industries likely have the great-

6. *See Denny's Settles Bias Suits*, BALTIMORE EVENING SUN, May 24, 1994, at 1A. The suits alleged that Denny's failed to serve African Americans or required them to pay a cover charge or pay before they received their meals. *See id.*

est risk of facing such claims, any organization that requires contact between its employees and outside parties is exposed. For example, employees of a manufacturing company typically stay within the premises manufacturing the company's product, but the company may also have a sales force that goes out and attempts to market their products. They may also be dependent on outside vendors, such as distributors and copy repair personnel, which necessarily leads to interaction between their employees and third parties. While contact with non-employees may be less frequent in these situations, there is still some level of exposure in virtually every organization for this type of claim.

V. PUNITIVE DAMAGES

Although coverage of punitive damages was once an emerging issue, it has now become a mandatory feature of coverage for employers who conduct business in a state that allows the insurability of punitive damages. The catastrophic exposure for most companies, aside from class actions, is a punitive damages award. Even an employee who made a modest salary can win millions of dollars in punitive damages. For the most part, insurers are now offering punitive damages as a standard coverage.

In those states that do not allow the insurability of punitive damages, insurance companies have attempted to provide punitive damages protection in creative ways. First, companies have pledged not to raise the uninsurability of the punitive damages as a defense to paying the damages. Second, they have endorsed the policy with a "most favored venue" endorsement, which is a choice of law provision that would apply the law of some other state to determine the insurability of the damages. Consequently, the states prohibiting the insurability of punitive damages have almost universally denied the use of these endorsements on admitted policy forms. Lastly, some insurers have set up offshore facilities or entered into relationships with foreign insurance companies to provide "wrap around" policies that will ultimately pay the damages. These policies are underwritten and sold completely offshore to companies within the United States, thus avoiding state regulation prohibitions. This method has become more popular over the last year, especially for larger accounts.

As EPLI coverage expands and more companies begin purchasing this coverage, punitive damages protection is going to continue to grow in importance. As a result, insurers will continue

to try to respond to insureds' requests for the protection, despite the public policy against insuring punitive damages in some states.

VI. WHO QUALIFIES AS AN EMPLOYEE?

In today's economy there are numerous kinds of employment relationships. Employment liabilities can be triggered even when the worker is not a traditional full-time employee. Most EPLI policies include full-time and part-time workers within the definition of "employee," and many policies will also include seasonal employees and temporary employees within the scope of the definition. Additionally, volunteer employees typically are not listed on EPLI policies, but most carriers will endorse the policy to include them as employees.

The two biggest questions regarding the breadth of the "employee" definition are the treatment of leased employees and independent contractors. Leased employees are technically employed by a third company that typically has contracts with numerous "client" companies. Pursuant to these contracts, the leasing company employs all of the client company's workers. Client companies prefer to structure the employment relationship in this manner for financial reasons, such as saving on insurance and other benefit-related expenses, since they can take advantage of the larger pool created by a number of client companies. Although the law in this area is still developing, it is prudent for client companies to assume that they will face exposure for the employment-related claims of their workers even if they are leased employees. The client company retains control over the leased employee in many ways, including performance reviews, salary evaluations, and hiring and firing. Consequently, the leasing arrangement is unlikely to shield an employer from liability for many employment practices liability claims. Hiring temporary staff is also prevalent in the economy and raises another set of questions. When a company calls a "temp help" company to obtain a worker for a short-term assignment, the worker remains employed by the temp help firm. The hiring, firing, salary, and performance duties are handled by the temp help firm. Consequently, claims from these employees for wrongful termination will be limited. However, claims for sexual harassment and discrimination are still possible.

Due to the proliferation of various employment relationships, there are many complexities in assessing the employment practices liability exposure facing companies. As discussed above, exposure

also exists for claims by third parties who interact with the company's workers. Thus, claims brought by virtually any person on account of the conduct of any person acting on behalf of the company creates potential employment practices liability.

VII. EXCLUSIONS—NOT MUCH LEFT

Three years ago, the exclusions in EPLI policies were many and severe. During the more recent evolution of the product, these exclusions have begun to disappear. What remains are a core group of exclusions that are truly designed to prevent EPLI from picking up damages unrelated to employment practices liabilities.

The EPLI policies of the past, and a few dinosaurs in the present, contained exclusions that effectively gutted the coverage purportedly being given. The worst of these exclusions was the "intentional acts" exclusion which barred coverage for claims that resulted from any intentional action of an insured. Although the organization will virtually never be deemed to have acted intentionally, the employee responsible for the wrongful act in question will almost always have acted intentionally. Under these policies the wrongdoer is also an insured, and therefore, all liabilities would be the result of an intentional act by some insured. When an employee is fired, sexually harassed, or discriminated against, someone has acted intentionally. With an intentional acts exclusion, all of these traditional employment practices liability situations could arguably be excluded from coverage. It should be no surprise that EPLI policies with this exclusion did not sell very well during the initial years.

Another popular exclusion in the past, and still present in a few policies today, is the "downsizing" exclusion. As typically drafted, the exclusion bars any claims that result from an organization's laying off or terminating a significant percentage of its employees. Obviously, employers desire EPLI coverage when such major turmoil increases their exposure. Consequently, this exclusion has mostly vanished from current EPLI policies. Underwriters address this increased exposure by assessing the company's financial condition prior to offering an EPLI policy. A company in poor financial condition is more likely to face reductions in force that could potentially trigger wrongful termination and other employment practices liability claims. Additionally, underwriters include the question "Does the Applicant anticipate any branch, location, or subsidiary closings, consolidations, or layoffs?" in the application for insur-

ance. By removing the exclusion and putting the majority of the burden on the underwriter to assess the potential for employment practices liability claims related to downsizing before the insurance is in place, modern EPLI policies offer the insured the protection that it needs for unforeseen business downturns.

A similarly drastic exclusion that appears from time to time is the "class action" exclusion. Simply put, it excludes coverage for claims that are brought as a class action. The intent of the insurers utilizing this exclusion is to limit their exposure to big dollar lawsuits that are brought by large numbers of plaintiffs. The obvious downside for the insured is a lack of coverage for a potentially large financial claim. Employers are constantly reading about huge verdicts and settlements in class action litigation. Examples include *Roberts v. Texaco Inc.*,⁷ (race discrimination), *Kraszewski v. State Farm General Ins. Co.*,⁸ (gender discrimination), *Griffin v. Home Depot Inc.*,⁹ (gender discrimination), and *Shores v. Publix Supermarkets Inc.*,¹⁰ (gender discrimination and sexual harassment). Combined, these cases resulted in settlements of approximately \$500 million. Most mainstream EPLI insurers have removed this exclusion from their policy forms, but the exclusion still occasionally appears.

Another traditional insurance exclusion present in early EPLI policies was the bodily injury/property damage ("BIPD") exclusion. As its name indicates, the BIPD typically carves out coverage for bodily injury, sickness, disease, death, or property damage. This is a standard exclusion in professional liability and other insurance policies. The typical damages in an employment practices liability lawsuit make application of this exclusion difficult. Most employment practices liability lawsuits will allege some element of emotional distress or humiliation-related damages. The type of "mental" injury is a common element to employment practices liability claims, but would likely be excluded from coverage with a traditional BIPD exclusion. BIPD exclusions on current EPLI policies typically address this problem by carving back coverage for these types of damages with language such as: "provided, that this EXCLUSION . . . does not apply to *Claims* for emotional distress, mental anguish, or humiliation actually or allegedly resulting from

7. 979 F. Supp. 185 (S.D.N.Y. 1997).

8. 139 F.R.D. 156 (N.D. Cal. 1991).

9. 168 F.R.D. 187 (E.D. La. 1996).

10. No. 95-1162-CIV-T-25E, 1997 WL 714787, at *1 (M.D. Fla. Jan. 27, 1997).

an *Employment Practices Wrongful Act*.”¹¹ This type of carve back language is an essential element to ensure full EPLI coverage.

The exclusions that remain in today’s EPLI policies mainly address liabilities arising under the Employee Retirement Income Security Act¹² (“ERISA”), workers’ compensation, unemployment, and other related laws. The statutorily mandated damages under these laws typically are covered by another form of insurance. Additionally, the damages under the statutes tend to be collateral to the core issues and damages in employment cases, and so they are properly regarded as better covered elsewhere.

VIII. EXPANDING GEOGRAPHICAL SCOPE FOR EPLI COVERAGE

Early EPLI policies typically restricted covered claims to those based on conduct occurring in the United States and only if the lawsuit was brought in the United States. For companies that have operations solely in the United States, this coverage may be adequate. However, such a restriction obviously poses a problem when an organization has foreign offices or substantial dealings in other countries. In the event that the company is sued in another country for something like wrongful termination or sexual harassment, traditional EPLI policies would not respond. Some policies evolved to cover conduct occurring anywhere in the world, but only for claims filed in the United States, based on the assumption that the likelihood of being sued in another country is remote. Nevertheless, the laws of foreign countries relating to employment liabilities are beginning to expand, just as they have in the United States, although perhaps not as rapidly. Even in a country like Japan, male dominated and anti-lawsuit by nature, the Japanese word for sexual harassment, “sekuhara,” has recently become more prevalent in business and in the media. One could make the argument that Japan and other countries are now at the same legal development stage that the United States was in 1990. As a result, future EPLI coverage can be expected to provide not only worldwide coverage, but also coverage for suits brought in foreign countries.

IX. DEFENDING THE CLAIM—THE SHIFT OF CONTROL

Early in the evolution of EPLI insurance most potential purchasers of the coverage lacked significant expertise in handling em-

11. Executive Risk EPLI Policy III(D) (2/97 ed.).

12. 29 U.S.C. § 1001-1169 (1994).

ployment practices liability claims. These policies provided a “duty to defend” the insured, which transferred control of litigation and settlement to the carrier in the event of a claim. An attractive element of the insurance for many employers was the claims experience of the carrier and the ability of the insurer to find and appoint qualified counsel in the event of a claim. Even though these early “Duty to Defend” policies were expensive and not very expansive in coverage, they did provide a good bit of defense-related “sleep at night” comfort to purchasers. However, as businesses have become more educated about employment practices liability exposure, there is less need to rely on an insurer for claims handling expertise.

As employment lawsuits have become more common, and with most companies having already experienced an employment practices liability claim, insureds are now more comfortable retaining control over the defense of these claims. With substantial deductibles and the company reputation on the line, insureds often feel the need to be the decision-maker in connection with handling claims. As a result, carriers have received many requests to amend the claims handling provisions of EPLI policies. Matters such as choice of defense counsel, notice of claim provisions, and settlement clauses have all been the subject of amendment requests by insureds. These requests may, in some cases, be coming not from the insured, but instead from the brokerage community trying to win over potential clients, and in some cases these issues have been raised by insurance companies that are working to have the most salable insurance product on the market. Several related issues have arisen in connection with the question of control over claims.

A. Duty to Defend v. Duty to Indemnity

As discussed above, the early EPLI policies tended to be “Duty to Defend” coverage. The insured receives two primary benefits from these policies. Clearly, the claims handling experience of the carrier is a plus. Facing an employment-related lawsuit can be daunting if an organization does not have an understanding of employment practices liability law or have ready access to qualified employment counsel. Being able to turn to an insurance partner with that kind of experience can be a priceless asset in the middle of a litigation storm. Another large benefit of these policies relates to the “duty” aspect. If one element of a claim is arguably covered by the policy, the insurance company has the duty to defend the entire claim. There is often no allocation of the defense expenses between

covered and uncovered elements of the claim. This “defend the whole claim” approach is extremely beneficial to a company wishing to control their costs in employment practices liability claims situations.

The trade-off is that an insured electing “Duty to Defend” coverage must surrender some element of control. Because an insurance company agrees to “defend the whole claim,” including specific causes of action that the policy it sold does not cover, it demands, and by virtue of the policy language is entitled to, the ability to manage the defense of that claim to insure that money is not wasted and that the claim is handled properly. As one example, “Duty to Defend” policies usually give the insurer the right to select defense counsel to represent the insured in the lawsuit. The carrier is in a good position to qualify the law firm chosen to ensure a quality and efficient defense. Additionally, the insurer is able to use its bargaining power to negotiate much lower hourly rates with firms specializing in employment litigation in exchange for volume. Whereas an insured may typically pay a quality employment lawyer \$260 per hour, an insurance company that has substantial business with that law firm may be paying that same firm less than \$200. The law firm accepts this lower rate in exchange for a larger flow of business, possibly in the millions of dollars annually, coming from the insurance company. In this situation the benefits flow to both the insured and the insurance company. The insured obtains more value for each deductible dollar spent, and the overall costs of the case will be less for the insurer.

Despite this naturally advantageous arrangement, insureds continue to have legitimate concerns about the qualifications of the law firm selected by the carrier. The first thing that will happen when the EPLI carrier selects a law firm to handle the claim is that the employer’s corporate counsel will advise its client: “You get what you pay for,” or, “There’s a reason the insurance company’s law firm is cheaper.” Such comments are designed, in part, to frighten the client into pressuring the EPLI carrier to retain their traditional law firm on employment cases, but they also do raise a legitimate concern for any insured—quality. An insurance company must be prepared to justify the qualifications of the law firm they are appointing to defend an insured.

Additionally, even if an insured does not dispute the qualifications of the law firm appointed by the carrier, it may wish to retain its traditional law firm due to the relationship and trust that they have developed over the years. When the insured has this concern,

there are a few possibilities. First, an insured desiring to retain this element of control can request that their policy be converted to an indemnity contract. This would typically enable the insured to select counsel of their choosing, in exchange for relinquishing the right to demand that the EPLI carrier "defend the whole claim," raising the possibility that the defense cost of the suit will be allocated among covered and non-covered claims. The second alternative is for the EPLI carrier to approve the insured's chosen law firm to handle the claims under the policy. Some insurers are more willing than others to enter into this type of arrangement. The insurer will typically look at two things in making the decision: the qualifications of the law firm to handle employment practices liability claims and the rates being charged by the firm. In the event both of these issues can be resolved to the satisfaction of the insurance company, some insurers will pre-approve the insured's law firm and retain the "Duty to Defend" character of the policy. Finally, there is the possibility that the insured and the insurer can agree that the insured's law firm will be appointed for the defense work, but that the insured will pay the difference between the amount the insurer will pay and the chosen firm's hourly rate being charged to the insured. Either by adopting one of the arrangements described above or some other arrangement, EPLI insurers are becoming more and more receptive to the idea of working with potential insureds to resolve their defense issues.

B. *Duty to Report Claims*

More and more frequently, insureds attempt to limit the situations under which they must report claims when they negotiate the terms of an EPLI policy. Obviously, employers would like to avoid reporting requirements for small claims without losing coverage for those situations that turn serious. This puts the insurance company in a precarious position, especially if the insurer has the duty and right to appoint counsel to represent the company, but the claim has proceeded to litigation without the insurer ever knowing of its existence. Of course, these issues are driven by the particular claims reporting requirements of the individual policy purchased by the insured.

EPLI policies vary in their claims reporting timing requirements. Many require that a claim be reported "as soon as practicable," a well-known insurance phrase, while others provide a set number of days within which the insured must notify the insurer of

the claim. Regardless of the time limit established in the policy, there is a point in time beyond which the insured will lose coverage for a claim that has gone unreported. Consequently, insureds seek to delay that point in time as much as possible while insurers seek to keep the reporting time at a reasonable level. The net result is a variety of compromises, some of which include:

- substantially limiting the number of individuals whose knowledge of the claim can trigger the notice requirement;
- expanding the time that the claim can be reported under the policy;
- setting a dollar threshold for claims that must be reported; and,
- creating a quarterly reporting structure that requires very minimal details about the claims (this is sometimes combined with the dollar threshold option mentioned above).

The insurer's willingness to agree to any of these requests is strongly influenced by its perception of the sophistication of the insured with regard to the handling of employment practices liability claims and the size of the deductible being carried by the insured. Needless to say, granting some of these amendments to an EPLI policy will be more likely if the company has an in-house counsel staff that is familiar with employment law and if the company is carrying a large deductible.

Whatever the situation, communication is essential, both pre- and post-binding of coverage. Pre-binding, the insured and insurer should communicate their desires and expectations so that there is a clear understanding of the terms of the relationship. The last thing either party wants is inadequate notice due to confusion over the terms of the policy, since denying a claim will result in a disappointed insured and a negative impact on the long-term relationship that insurers seek to foster.

C. Settling Claims

Traditional EPLI policies gave the insurer the right to settle claims under the policy, often without the consent of the insured. Insureds, over time, have rightfully taken issue with the ability of an insurer to settle a claim against it without any input from them. The pendulum has now swung back drastically in the other direction. Insureds today are often demanding the authority to settle a claim, taking dead aim at an important standard insurance contract provision that facilitates EPLI carriers' control over litigation.

The settlement clause is commonly referred to as "the hammer." To summarize the typical settlement clause, if an insurer could have settled a claim for \$100 but the insured refused to agree, and the claim eventually is resolved for \$500, the insurer would only be obligated to cover the first \$100, with the remaining \$400 remaining uninsured. Such a clause therefore permits the insured to object to a settlement opportunity, but it requires the insured to bear the cost of making a bad decision.

Coinurance of the settlement clause has become a popular coverage enhancement in recent years. In the example cited above, the \$400 would be shared by the insurer and insured in the event the insured refused to settle when the insurer could have done so. Typical percentages in the marketplace today are 50%-50% and occasionally 70%-30% (the larger percentage being borne by the insurer). This compromise has the benefit of providing financial support to the insured in catastrophic claims situations while giving the insured a strong incentive to weigh a settlement opportunity carefully once it is recommended by the insurer.

Increasingly, the insured and/or broker are pushing to have the settlement clause deleted altogether. This approach, while beneficial to the insured, is very unattractive to the insurer. In this situation, the party that has the greatest financial exposure at stake would have no ability to bring the claim to a close quickly and efficiently. The entire limit of liability being assumed by the insurer would be under the control of the insured when viable settlement options are present. Understandably, this option is least favored by insurers.

It is critical that an insured and its broker not confuse the realities connected with the control of settlement. Yes, there is control on the part of the insurance company when it comes to the settlement clause. However, the insurer is often the only unemotional party in these disputes. Of all forms of litigation, employment disputes are arguably the most emotional. These emotions can lead to imprudent decisions in the claims handling and settlement arena, which can lead to increased loss. Having the insurance company, an objective party, involved in the settlement process with some degree of authority can be extremely beneficial to all parties to the dispute. More importantly, the insurance company will have its own reputation for handling claims in mind as they negotiate. Some companies are notorious for not paying claims and litigating with their insureds. Settlement clauses in these companies' policies are of much greater concern. Other companies have built their en-

tire reputation upon good faith claims handling designed to meet the insured's needs and expectations, and so for these companies the settlement clause will likely be less of an issue.

The settlement clause, while often a focus in the purchase of an EPLI policy, is really representative of a much larger issue: determining whether the insurance company is going to treat the insured fairly when it submits a claim. When boiled down to its essence, insureds are really purchasing the claims handling function of an insurance company. That should be, although often it is not, one of the core elements in deciding between the products offered by competing carriers.

CONCLUSION

In the preceding discussion I have highlighted the changing nature of EPLI coverage. This discussion has been selective, since there are other features of EPLI policies undergoing change. Some examples include cancellation provisions, acquisition thresholds, and reporting periods. Cancellation provisions have been amended such that carriers have relinquished cancellation rights other than for non-payment of premiums. Acquisition thresholds have increased, giving the insured more flexibility when acquiring another entity. Extended reporting periods have lengthened, and their cost has dropped. Overall, nearly every aspect of the EPLI policy has been softened in favor of the insured, or can be softened through negotiation with most carriers.

As employment practices liability laws change, so too must the insurance policies designed to cover them. To date, the insurance policies have been changing as quickly and as dramatically as the laws themselves. As we look into the crystal ball, there is no sign that either are going to slow down in the near future. Communication with the insurance carrier and open dialogue between all parties will result in solid coverage that makes sense for all concerned in this challenging and dynamic environment.